

Before The  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2014

Docket No. ACR2014

**NOTICE OF THE UNITED STATES POSTAL SERVICE OF  
FILING PARTIAL SUPPLEMENTAL INFORMATION  
IN RESPONSE TO ORDER NO. 2313**  
(January 15, 2015)

In its FY 2014 Annual Compliance Report, filed on December 29, 2014, the Postal Service noted that it was unable to provide information required to be filed as part of this year's Annual Compliance Review due to the unavailability of operations staff during the peak holiday mailing season.<sup>1</sup> The supplemental information responds to directives from the Annual Compliance Determination Reports for Fiscal Years 2010 and 2013, which seek updates on operational and pricing initiatives relating to Standard Mail Flats and Periodicals.<sup>2</sup> The Postal Service committed to filing this information in early January.<sup>3</sup> Subsequently, in Order No. 2313, the Commission ordered the Postal Service to provide the supplemental information no later than January 5, 2015.<sup>4</sup> In response to Order No. 2313, the Postal Service hereby files the currently available supplemental information as Attachment A to this pleading.

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<sup>1</sup> United States Postal Service FY2014 Annual Compliance Report (hereinafter "ACR 2014"), PRC Docket No. ACR2014 (Dec. 29, 2014), at 19 n.7; Id. at 32 n.14.

<sup>2</sup> FY 2010 Annual Compliance Determination Report, PRC Docket No. ACR2010 (Mar. 29, 2011), at 107; Annual Compliance Determination Report Fiscal Year 2013, PRC Docket No. ACR2013 (Mar. 27, 2014), at 7.

<sup>3</sup> ACR 2013, at 19 n.7; Id. at 32 n.14.

<sup>4</sup> Order No. 2313: Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, PRC Docket No. ACR2014, at 4 (Dec. 31, 2014).

This information is described as that currently available because, unfortunately, the Postal Service has as of yet still been unable to complete all of the analysis it believes might be useful in addressing the situation with respect to Standard Mail Flats. The nature of the problem was described on page one of the Preface to the IOCS documentation folder, USPS-FY14-37:

An adjustment was made to account for change in markings of Standard Mail. Some flats mailings that paid carrier route prices received permission to use "FSS" instead of "ECR" carrier route markings and to use STIDs in barcodes indicating Standard Regular rather than carrier route. Luckily, beginning in FY14, IOCS records the presence of the "FSS" marking on mailpieces. Data from PostalOne on the rate composition of FSS bundles is used to split the costs associated with Standard Mail "FSS"-marked pieces into Standard Regular Flats, ECR-Basic and ECR-HD/WSS in proportion to volume.

Since the ACR was filed, the Postal Service has been attempting to refine its review of potential misallocation of IOCS tallies because of marking issues (as alluded to above) by extending the exercise to include analysis on a tally-by-tally basis. Although extremely time consuming, matching the STID associated with each tally by the data collector (obtained from a scan of the IMb code on the mailpiece) with mailing statement information from the Mail.dat database, may make it possible to identify the actual rate category within which the tested piece was entered, regardless of the presence or absence of markings on the piece. Though this analysis is limited to IOCS tallies, and thus does not address street carrier costs or transportation costs, it may shed more light on whether the marking issue is likely to help explain (in small or large part) the unexpected increase in the costs as reported in the FY 2014 CRA for Standard Mail Flats.

Although the Postal Service is making progress on this laborious analysis, it is still not completed. Rather than wait further for complete results from this process before submitting any of the supplemental information which is the subject of Order No. 2313, the Postal Service is today providing the supplemental information that it has currently compiled. The attached, therefore, takes as given the Standard Mail Flats costs reported in the FY 2014 CRA. If any of the subsequent tally analysis by the Postal Service described above indicates that material revisions in those CRA costs might be warranted (which has not been established at this time), it will promptly provide details of the analysis and its conclusions.

Respectfully submitted,

UNITED STATES POSTAL SERVICE  
By its attorneys:

Daniel J. Foucheaux, Jr.  
Chief Counsel, Pricing and Product Support

Eric P. Koetting  
John F. Rosato

475 L'Enfant Plaza, S.W.  
Washington, D.C. 20260-1137  
(202) 268-8597; Fax – 6187  
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### SUPPLEMENTAL INFORMATION

In the FY 2010 Annual Compliance Determination Report (“FY 2010 ACD”), the Commission ordered the Postal Service to provide the following information about Standard Mail Flats in each subsequent Annual Compliance Report:

- a) all operational changes designed to reduce flats costs in the previous fiscal year and estimate the financial effects of such changes;
- b) all costing methodology improvements made in the previous fiscal year and estimate the financial effects of such changes; and
- c) a statement summarizing the historical and current fiscal year subsidy of the flats product; and estimated timeline for phasing out this subsidy.<sup>1</sup>

Similarly, in the Annual Compliance Determination Report Fiscal Year 2013 (“FY 2013 ACD”), the Commission ordered the Postal Service to provide the following information, in its FY 2014 Annual Compliance Report, about the progress made in improving Periodicals cost coverage:

- a) The impact of leveraging its pricing flexibility to improve the efficiency of Periodicals pricing;
- b) The impact of the implementation of operational strategies outlined in Chapter 7 of the Periodicals Mail Study; and
- c) The progress in implementing pricing strategies outlined in Chapter 7 of the Periodicals Mail Study.<sup>2</sup>

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<sup>1</sup> Annual Compliance Determination Report: Fiscal Year 2010, PRC Docket No. ACR2010 (Mar. 29, 2011), at 106.

<sup>2</sup> Annual Compliance Determination Report: Fiscal Year 2013, PRC Docket No. ACR2013 (Mar. 27, 2014), at 7.

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The information provided below responds to each of the above requirements. In particular, the section titled Standard Mail Flats Responses addresses requirements (b) and (c) from the Commission's order in the FY 2010 ACD. The section titled Operational Initiatives addresses requirement (a) from the order in the FY 2010 ACD, and requirement (b) in the order from the FY 2013 ACD. The section titled Periodicals Pricing addresses requirements (a) and (c) from the order in the FY 2013 ACD.

### **Standard Mail Flats Responses**

Three costing methodology changes affected Standard Mail Flats costs in FY 2014, one from Docket No. RM2014-4: Proposal Two, one from Docket No. RM2014-6: Proposal Six, and one from Docket No. RM2015-4: Proposal Eleven. As the subsequent table shows, however, the effects of the changes were minimal.

<b>Proposal</b>	<b>Topic</b>	<b>FY 2013 Estimated Impact (\$000)</b>
Two	Fed Ex Night Turn Cost Segment 14	(398)
Six	Highway Variability	4,554
Eleven	Credit and Debit Card Fees	(1,508)
Total		2,648

The additional \$2.6 million in relevant costs accounted for only 0.11 percent of the FY 2013 total attributable costs for Standard Mail Flats (\$2.51 billion). In FY 2014, the unit cost of Standard Mail Flats was 49.4 cents. Of the 49.4 cents, 0.05 cents (or 0.11 percent of 49.4 cents) was associated with the three methodology changes listed above.

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With respect to Standard Mail Flats' financial shortfall, the below table summarizes the gap between revenues and costs from FY 2008 through FY 2014 (including the FY 2014 CRA as currently reported):

<b>Year</b>	<b>Revenue (millions)</b>	<b>Cost (millions)</b>	<b>Shortfall (millions)</b>
<b>2008</b>	\$3,664	\$3,891	\$227
<b>2009</b>	\$2,866	\$3,488	\$622
<b>2010</b>	\$2,579	\$3,161	\$582
<b>2011</b>	\$2,491	\$3,143	\$652
<b>2012</b>	\$2,230	\$2,762	\$532
<b>2013</b>	\$2,134	\$2,514	\$380
<b>2014</b>	\$2,037	\$2,497	\$460

As the Postal Service has consistently explained, it is very difficult to predict when the shortfall for Standard Mail Flats will be phased out. While the Postal Service has committed to increasing Standard Mail Flats prices by at least CPI x 1.05 during the next two market-dominant price changes, it is unlikely that the shortfall will be eliminated by the end of 2016, when the Commission will commence a comprehensive review of the present regulatory system.<sup>3</sup> The prospects for eliminating the shortfall thereafter will depend not only on pricing and cost saving initiatives, but also on any changes made to applicable regulations by the Commission. Nevertheless, it is noteworthy that the Postal Service has reduced the Standard Mail Flats shortfall in FY 2014 to \$192 million less than it was when the shortfall peaked in FY 2011.

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<sup>3</sup> 39 USC § 3622(d)(3).

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### **Operational Initiatives**

Below, the Postal Service describes the new and ongoing steps it took during FY 2014 to make its processing of Flats and Periodicals mail more efficient. Collectively, these efforts are expected to improve efficiencies and productivities, and reduce overall Flats and Periodicals costs. No analysis has been performed to isolate the cost savings resulting from the above initiatives, assuming such an analysis were even possible with available data.

This below information includes updates concerning “Moving Mail Up the Ladder” and the “Automated Parcel and Bundle Sorter,” both of which were specifically mentioned in Chapter 7 of the Periodicals Mail Study. Information about the Phase 1 deployment of Flats Sequencing System (“FSS”) machines, which was also mentioned in Chapter 7 of the Periodicals Mail Study, was provided to the Commission during the Annual Compliance Review for FY 2011 (when Phase 1 was completed).<sup>4</sup> With the deployment of FSS machines now fully completed, the Postal Service’s cost savings efforts are primarily focused on making more Flats and Periodicals mail available for FSS processing.

- **FSS Scorecard**

The Postal Service continues using an “FSS scorecard,” which measures critical aspects of FSS performance at each processing location. The scorecard is utilized to develop a list of specific sites with the greatest opportunity for improvement. The below table reflects the Postal Service’s performance on the key metrics utilized by the scorecard. Of particular note is the increase in the “At

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<sup>4</sup> Please see Postal Service response to Question 9, ChIR No. 1, Docket No. ACR2011 (Jan 27, 2012).

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Risk” indicator. The rise in this indicator is largely due to an increase in double feeds, which was caused by a modification that was made to the FSS machines to reduce damage to mail pieces. Efforts are underway to address the increase in double feeds.

Performance Metric	FY 13	FY 14
Throughput per hour (pph)	8,985	8,746
DPS %	57.90%	58.57%
Mail Pieces AT-Risk %	5.84%	6.15%

**Sources:**

Throughput per hour: WebEOR

DPS%: EDW

AT-Risk%: MIRS

- **Move Mail Up the Ladder**

In FY 2014, the Postal Service continued its efforts to move mail up the ladder to automation. Due to a lull in facility consolidations, the number of facilities that continue to process Flats and Periodicals mail in a fully manual environment remained at 15 in FY 2014. Additionally, the percentage of flats processed manually increased to 9.8 percent in FY 2014. The Postal Service attributes this increase to a combination of the consolidations that happened in the last quarter of FY 2013 and the extreme weather experienced during the winter of 2014. The number and severity of the winter storms resulted in volumes which were processed by any means possible to provide service to our customers.



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- **Bundle Operation**

In FY2014 the Postal Service began expanding the capacity of APBS units by adding 1,936 bins for sortation. The below table reflects the throughput per hour for APPS and APBS machines.

Machine Type	FY 13	FY 14
APBS	3,825	4,113
APPS	6,000	5,896

Source: WebEOR

- **Service Performance Diagnostics Tool**

The Postal Service continued to utilize the Service Performance Diagnostics tool ("SPD") to track and improve the flow of Standard and Periodical Mail being processed through the network. Additional reporting capabilities and diagnostic breakdowns were added to the system during FY 2014. These enhancements helped to improve the median cycle time for Standard Mail SCF flats from 50.5 hours in FY 2013 to 49 hours in FY 2014 and Periodical Mail SCF flats from 24 hours in FY 2013 to 21 hours in FY 2014.

### Median 5 Day MP WIP Standard Mail Flats

Time Period from SPD	SCF Weighted Median
(FY 13) Week ending 10/19/12 - 09/27/13	50.5
(FY 14) Week ending 10/01/13 - 09/30/14	49

### Median 5 Day MP WIP Periodical Mail Flats

Time Period from SPD	SCF Weighted Median
(FY 13) Week ending 10/19/12 - 09/27/13	24
(FY 14) Week ending 10/01/13 - 09/30/14	21

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- **High Speed Flats Feeder (“HSFF”)**

The HSFF increases FSS efficiency by optimizing bin capacities, resulting in increased throughput. In FY2014, the Postal Service tested the HSFF in two sites, the Dulles P&DC and the Philadelphia P&DC. The charts below represent the improvements realized as a result of the HSFF deployment. The Postal Service is currently evaluating the status of the HSFF program.

Dulles Summary Sept 1 - Nov 17, 2014			
	Without HSFF FSS 1, 3, 4	HSFF	HSFF % Improvement
Runs	1454	422	na
Average Pieces Fed	11150982	13158552	18%
Avg Pcs per Run	23008	31181	36%
Pass 1 Throughput	27152	26140	-4%
Pass 2 Throughput (all runs)	21749	26372	21%
Pass 2 Throughput (VM4 only)	23283		13%
Pass 2 Throughput (VM2 only)	15486		70%
2-Pass Throughput (all runs)	9487	11150	18%
2-Pass Throughput (VM4 only)	9751		14%
2-Pass Throughput (VM2 only)	8410		33%
<b>Accept Rate</b>	<b>91.45</b>	<b>94.93</b>	<b>3.81%</b>
Average Op Hours per Day	15.6	15.25	-2.27%
Destacker Jam Rate Pass 1	1680	7646	355%
Destacker Jam Rate Pass 2	2710	10500	288%
<b>Multifeed Rate</b>	<b>1.87%</b>	<b>0.75%</b>	<b>60%</b>
%VM4 Runs	80%	0%	na

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Philadelphia Summary Sept 1 - Nov 17, 2014			
	Without HSFF FSS 1	HSFF	HSFF % Improvement
Runs	422	444	na
Average Pieces Fed	12046388	14422646	20%
Avg Pcs per Run	28546	32483	14%
Pass 1 Throughput	27501	28060	2%
Pass 2 Throughput (all runs)	22523	29948	33%
Pass 2 Throughput (VM4 only)	24868		20%
Pass 2 Throughput (VM2 only)	16033		87%
2-Pass Throughput (all runs)	10582	12541	19%
2-Pass Throughput (VM4 only)	11121		13%
2-Pass Throughput (VM2 only)	9091		38%
<b>Accept Rate</b>	<b>90.37</b>	<b>94.05</b>	<b>4.07%</b>
Average Op Hours per Day	14.56	14.66	0.72%
Destacker Jam Rate Pass 1	1139	6655	484%
Destacker Jam Rate Pass 2	2261	10349	358%
<b>Multifeed Rate</b>	<b>2.27%</b>	<b>1.00%</b>	<b>56%</b>
%VM4 Runs	73%	0%	na

- **FSS Bi-Weekly Meetings**

These meetings are held with Area FSS Coordinators and focus on improvement efforts for key performance indicators, including throughput per hour, machine utilization, and equipment downtime. Each Area provides an update on the activities associated with their action plans for improving FSS Performance.

- **Flat Recognition Improvement Program (“FRIP”) – Software Upgrade**

The FRIP will increase address recognition rates and reduce error rates on AFSM100 and FSS equipment. Achieving a higher encode rate will result in improved customer service, reduced keying hours at the Remote Encoding Center (“REC”), and reduced manual distribution operations at the processing

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plants and delivery units. The first release, which was completed in July 2014, resulted in 49.9 percent fewer images being keyed at the REC.

- **Lean Mail Processing (“LMP”)**

In FY 2014, the Postal Service began the National deployment of LMP in 276 Mail Processing facilities, based on the initial phase of LMP activities at the South Jersey P&DC. At South Jersey, all mail processing operations were analyzed for efficiency improvement opportunities. The activities from the initial phase were described in the Postal Service’s response to CHIR 2, Question 1, in Docket No. ACR2013. Additionally, using Lean Six Sigma principles, process improvement teams (consisting of Headquarters Engineering staff and management/craft employees at the South Jersey plant) moved forward with phase 2 improvement initiatives, including the following:

1. Expansion of FAST appointments to meet our customers’ needs and to better align mail acceptance with processing windows;
2. Operational and data reviews to reduce late transportation departing the processing facility;
3. Reduction of letters processed on flat sorting equipment;

The first and second phases of the LMP project were presented at the Institute of Industrial Engineers’ Lean Six Sigma conference in Atlanta, and were awarded 1<sup>st</sup> place.

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- **FSS Training**

In FY 2014, Management from the 46 FSS sites participated in FSS refresher training. This training focused on operational performance, proper mail flow, and “At Risk” indicators to help improve key performance metrics, including throughput per hour, machine utilization, and equipment downtime.

- **FSS Mail Preparation**

In January of 2014 the Postal Service required that Flats and Periodicals mail, destined for ZIP Codes that are processed on FSS equipment, would have to be prepared as FSS Scheme bundles. Additionally, if any FSS Scheme bundle identified on the L006 label list reached a 250 lbs threshold, the Postal Service required that it be prepared as an FSS Scheme pallet. Below is a description of the benefits of FSS Scheme bundle and FSS Scheme pallet preparation.

***FSS Scheme Bundles:*** Required preparation to mirror the FSS sort programs saves mail processing time and effort. The more large and uniform-sized bundles that are created by the mail service providers, the fewer the number of bundles that the Postal Service has to handle through the mail processing network. In addition, the requirements will result in more uniform bundles, which benefit both the Postal Service and mailers in terms of reduced preparation expenses for mailers, and more efficient FSS processing for the Postal Service. Though these requirements became effective in January of 2014, the industry was given a grace period for achieving full compliance. Accordingly, the full benefits of this

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preparation requirement did not become visible until Quarters 3 & 4 of FY 2014. During these quarters, the Postal Service experienced a reduction of over 14 million bundles over the same period last year.

***FSS Scheme Pallets:*** These pallets bypass bundle distribution on the APPS/APBS and go directly to the Stand Alone Mail Prep (SAMP). With less handling, the bundles on these scheme pallets are much less likely to break apart and the flats receive less wear and tear, arriving in the mailbox in better condition. In order to maximize the quantity of flats sequenced on FSS, the mail must arrive at the SAMP a minimum of one hour prior to the scheduled run for that zone. These scheme pallets will provide more flats to the SAMP earlier in the day as they bypass the bundle distribution operation. Mailers have the option of dropping these pallets at the FSS site, which is often located in a different building than the SCF. Entry directly at the FSS site reduces Postal Service transportation expenses and improves service. Mailers are required to make a pallet with 250 lbs or more of flats for an FSS scheme.

- **Reduce Bundle Breakage**

The Postal Service has been working with the mailing industry (through the Mailers Technical Advisory Committee) to study the causes and impacts of bundle breakage, and to jointly lead a Lean Six Sigma initiative aimed at reducing the breakage rate. Bundle breakage results in higher processing costs for the Postal Service as well as potential damage to mailpieces. When bundles

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lose their presort integrity prior to being completely processed, the Postal Service then must handle the individual pieces, which incurs higher handling costs. Accordingly, reducing bundle breakage benefits both the Postal Service and the Mailing industry.

### **Periodicals Pricing**

As requested in the FY 2013 ACD the Postal Service provides the following discussion of pricing progress with regards to Periodicals. As acknowledged in the FY 2013 ACR, the Postal Service shares the Commission's concern about Periodicals cost coverage, and, as stated in the *Periodicals Mail Study*, "the Postal Service and the Commission will continue to work together to identify and address challenges related to Periodicals."<sup>5</sup>

Overall, cost coverages have improved slightly since FY 2010. In terms of pricing, the Postal Service has not taken steps to date to change the Periodicals classification to align with First-Class Mail and Standard Mail as recommended in Chapter 7 of the *Periodicals Mail Study*. However, as a general rule, in recent price increases the Postal Service has increased the Periodicals rate elements across the board, as was done in both Docket Nos. R2103-10 and R2013-11. In general the Postal Service was concerned about the impact on various size publications and wanted to keep the impact of CPI price changes within a narrow range around the overall CPI increase for both small and large publications. In Docket No. R2013-11, the Postal Service did not want to use the Exigent Rate Case as a mechanism to address

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<sup>5</sup> *Periodicals Mail Study*, September 2011, at 3.

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systemic or perceived problems in the design of the Postal Rate Structure. A significantly large increase for Periodicals could turn out to be counter-productive if it leads to smaller niche publications going out of business. Magazines make a significant contribution to the mail moment experience and it is important to keep them relevant.

Additionally, in the next market dominant price adjustment filed concurrently with this response, the Postal Service plans to take further measures to provide efficient pricing signals to the mailers. In particular, the Postal Service plans to set the prices for the bundles and pallets based on the estimated costs of handling them. Some exceptions may be made either to avoid truly exorbitant increases, or in some cases, to provide incentive to encourage desirable behavior. Given the constraint of the low CPI, the Postal Service plans to achieve this by reducing the pound prices. Reducing the revenue burden on pounds started with the structural change in Docket No. R2006-1. Reduced pound prices are beneficial to both the Postal Service and Periodicals customers. Indeed, within the weight range of typical mail pieces (3 to 16 ounces), piece weight is not a significant cost driver. Additionally, the productivity of mail processing equipment (AFSM 100, FSS, APBS or APPS) is not significantly impacted by minor weight increases. Finally, Periodicals customers, both recipients and producers, benefit through the postage reduction on content. As in the recent past, we plan to keep in mind the impact of significant price increases on the wide variety of publications.

The Postal Service began to take steps to align Periodicals with operational priorities last year. In order to maximize the efficiency gains from the FSS machines, the Postal Service implemented two FSS elements for Periodicals with Docket No.



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R2013-10. First, we required FSS preparation for all flat-shaped periodical mail pieces destinating in FSS zones. This preparation had previously been optional. The FSS prices were designed to minimize changes in postage for flats mailers. Second, we introduced a significant pallet discount for mail on FSS scheme pallets that were entered at the location of the destinating FSS machine (DFSS), i.e. these pallets were charged a zero price. Entry of mail at DFSS locations avoids transportation costs, reduces/eliminates bundle sorting, and improves service.

In the next market dominant price adjustment the Postal Service will also take additional steps to encourage DFSS entry. We plan to propose a separate price structure for FSS that provides the lowest combined price to FSS scheme bundles on scheme containers. To accomplish this we propose creating FSS piece prices within Periodicals (Outside County). In addition, we will propose revising regulations to permit mailers to enter FSS scheme sacks and tubs at the DFSS sites. Lastly, we will propose permitting mailers to enter FSS non-scheme or facility containers at the DFSS sites.

For those Periodicals in a non-FSS environment, the Postal Service plans to encourage the entry of more carrier route pallets. A majority of the non-FSS carrier route bundles in Periodicals are entered at postal facilities on 3-Digit pallets. These pallets are more expensive to process than Carrier Route Bundles entered on 5-Digit and Carrier Route pallets. For Periodicals, we want to encourage mailers to prepare more direct pallets. Accordingly, we have priced Carrier Route bundles entered on 5-Digit and Carrier Route pallets with the lowest price available for Non-FSS regular Periodicals. Pricing the bundles and pallets at their estimated costs, should provide mailers with incentives to move these Carrier Route bundles to 5-Digit pallets. The

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introduction of a pure Carrier Route pallet is intended to provide an alternative that would reduce this material handling burden significantly.

More generally, while the Postal Service will continue to pursue whatever efficiency enhancements are possible, it is extremely doubtful, in the context of price increases limited to the CPI cap, that the Periodicals class can achieve 100 percent cost coverage.